BEFORE THE
TENNESSEE STATE BOARD OF EQUALIZATION

In Re:	FFC Housing Company District 8, Map 109N, Group C, Control Map 109N, Parcel 2 District 9, Map 134H, Group A, Control Map 134H, Parcel 7, Special Interest 000 District 10, Map 87M, Group D, Control Map 87M, Parcel 9 *Claim of Exemption*	))))))))	Greene County

INITIAL DECISION AND ORDER

Statement of the Case

These are appeals pursuant to Tenn. Code Ann. section 67-5-212(b)(2) from denials of applications for exemption of the subject properties from ad valorem taxation. The applications were filed with the State Board of Equalization ("State Board") on May 19, 2005. By letter dated February 22, 2006, State Board staff attorney Emily Bennett notified the applicant of the denials on the following grounds:

> The property does not meet the requirements set forth in Tennessee Code Annotated section 67-5-207 for exemption of low income housing for elderly or disabled persons. The property is not financed by any of the grants or funding programs enumerated in the statute. Furthermore, the property does not qualify for a charitable exemption under Tennessee Code Annotated section 67-5-212. The lease agreement between FFC Housing Company and Life Action Tennessee, Inc. requires rental payments in an amount that exceeds the $1 per year allowed under that statute.

FFC Housing Company ("FFC"), the applicant and owner of the properties in question, appealed this initial determination to the State Board on May 23, 2006. The undersigned administrative judge conducted a hearing of this matter on September 19, 2006 in Greeneville. FFC was represented by Paul D. Krivacka, Esq., of Adams and Reese, LLP (Nashville).[1] Greene County Assessor of Property Ralph Bowers was accompanied by staff commercial/industrial appraiser Chuck Jeffers and exemptions clerk Shana Riddle.

Findings of Fact and Conclusions of Law

FFC, an Ohio nonprofit corporation, was formed in 2004 "to develop and implement housing solutions for people of challenge that improve their quality of life and to provide support and assistance as needed to oversee and manage such housing solutions." Articles of Incorporation (Third). The sole member of FFC was a Dublin, Ohio-based "501(c)(3)" organization known as the Foundation for the Challenged ("FC"). Essentially, FC is engaged in the acquisition, renovation, and rental of affordable housing for persons with developmental

[1]Mr. Krivacka filed a Post-Trial Brief on FFC's behalf on October 26, 2006.

disabilities. FC has obtained a certificate of authority to do business in this state, effective April 26, 2005. FFC merged into FC in March, 2006.

As explained by FC's Vice President/Housing & Development Michael A. Mess, in the wake of a 1999 decision of the United States Supreme Court[2], the national trend has been toward deinstitutionalization of developmentally disabled persons. Accordingly, FC has accumulated a portfolio of 71 "community-based" homes for such persons in ten different states. These assets were financed by a combination of conventional mortgage loans and government grants.[3] FC derives its revenue primarily from rents and investments.

At issue in these appeals are three single-family residences in Greeneville that FFC purchased on December 23, 2004 from Life Action Tennessee, Inc. ("LAT") – another 501(c)(3) organization which was providing round-the clock developmental disability services to the residents under contract with the Division of Mental Retardation Services (DMRS) of the Tennessee Department of Mental Health and Developmental Disabilities. FFC immediately leased these properties back to LAT under a one-year (renewable) master agreement which restricts usage of them solely for that purpose.[4] This lease requires LAT to pay FFC (now FC) a monthly rental of $19,918.49 (with a 2% escalator for each annual renewal term). LAT must also pay utility charges.[5] But the agreement recites that:

> [T]he parties hereto entered into this Lease in reliance upon assurances from (DMRS) to provide additional rental subsidies, including but not limited to, M R Dollars, STRAP Fund and other amounts necessary to enable individuals who will be subleasing the property from the Tenant to pay the rental amounts under subleases, as a supplement to those finds provided the individuals by the Social Security Administration.

LAT has, in turn, executed sublease agreements with the conservators for the developmentally disabled residents of the subject houses. The rents payable by those subtenants equal the total rent due to FFC under the master lease agreement. Thus Mr. Mess characterized LAT as merely a conduit for the transfer of state subsidies and federal (SSI) benefits from the residents to FC.[6] In his view, then, FC does not really charge LAT any rent for its use of these properties.

Apparently in response to the adverse ruling under appeal, FC has proposed (effective September 1, 2006) to lease the subject properties directly to LAT"s clients "only for residential

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[2]Olmstead v. L.C. *ex rel.* Zimring, 527 U.S. 581, 119 S.Ct. 2176 (1999).

[3]FC has been awarded some $3.3 million in affordable housing grants over the past 18-month period.

[4]The master lease agreement also covers similar properties owned by FFC elsewhere in this state.

[5]FFC is responsible for payment of any real estate taxes assessed on the subject properties.

[6]Mr. Mess estimated that approximately 75% of FC's rental income is applied to debt service, with the remainder offsetting operating expenses and administrative costs.

purposes" at the same rate. Exhibits 5—11. Under this arrangement – not finalized as of the date of hearing – the residents would authorize LAT to act as their "agent" in matters pertaining to the lease.

Article II, section 28 of the Tennessee Constitution permits the legislature to exempt from taxation property which is "held and used for purposes purely religious, charitable, scientific, literary, or educational." Under this authority, the General Assembly has decreed that:

> There shall be exempt from property taxation the real and personal property, or any part thereof, owned by any religious, charitable, scientific or nonprofit educational institution which is **occupied and used by such institution or its officers** purely and exclusively for carrying out thereupon one (1) or more of the purposes for which the institution was created or exists, or which is **occupied and used by another exempt institution** purely and exclusively for one (1) or more of the purposes for which it was created or exists under an arrangement whereunder the owning institution **receives no more rent than one dollar ($1.00) per year**; provided that the owning institution may receive a reasonable service and maintenance fee for such use of the property...[Emphasis added.]

Tenn. Code Ann. section 67-5-212(a)(1)(A). The law further provides, however, that:

> The real property of any such institution not so used exclusively for carrying out thereupon one (1) or more of such purposes, but **leased** or otherwise used for other purposes, whether the income received therefrom be used for one (1) or more of such purposes or not, shall not be exempt...[Emphasis added.]

Tenn. Code Ann. section 67-5-212(a)(3).

For property tax exemption purposes, the term *charitable institution* is broadly defined in Tenn. Code Ann. section 67-5-212(c) to include "any nonprofit organization or association devoting its efforts and property, or any portion thereof, exclusively to the improvement of human rights and/or conditions in the community."

In this state, contrary to most other jurisdictions, property tax exemptions are liberally construed in favor of religious, charitable, scientific, and educational institutions. *See*, e.g., Youth Programs, Inc. v. Tennessee State Board of Equalization, 170 S.W.3d 92 (Tenn. Ct. App. 2004). Nevertheless, as the party appealing from the initial determination on its applications for exemption, FFC has the burden of proof in this administrative proceeding. State Board Rule 0600-1-.11(2).

Subject to certain conditions, Tenn. Code Ann. section 67-5-207 specifically exempts various types of federally subsidized projects which are owned by a nonprofit corporation and "used for permanent housing of low income persons with disabilities, or low income elderly or handicapped persons." FC does not contend that the properties in question qualify for exemption under this statute. Rather, notwithstanding its lease of these residences, the appellant claims exemption thereof under the general terms of Tenn. Code Ann. section 67-5-212(a)(1)(A). Tenn. Code Ann. section 67-5-207(e) states that:

> Nothing in this section shall be construed to preclude the application of section 67-5-212 to **transitional** or **temporary** housing that qualifies as a charitable use of property under that section. [Emphasis added.]

The wording of this proviso implies that the legislature never contemplated exemption under Tenn. Code Ann. section 67-5-212 of residential property which is used for the *permanent* housing of developmentally handicapped individuals. To be sure, as pointed out by counsel for FC, the aforementioned sublease "does not convey any interest that would approach a fee simple or permanent interest in property." Post-Trial Brief, p. 13. But a residence is not necessarily "transitional" or "temporary" just because the occupant does not own it. Nor does the fact that the individual sublessees may not live in these particular houses forever mean that they are not "permanent" residences in the context of Tenn. Code Ann. section 67-5-207.

Moreover, even if the subject properties were properly characterized as transitional or temporary housing, the fact remains that FC actually *receives* far more than the one-dollar-per-year rent (plus reasonable service and maintenance fee) allowed under Tenn. Code Ann. section 67-5-212(a)(1)(A). Indeed, the rent covers practically *all* of the expenses associated with ownership of these properties (including debt service); and the corporation stands to reap the benefit from any appreciation of such properties.

It is understood that the rents payable to FC may not really come out of the "pocket" of the tenant (LAT) or, for that matter, the sublessees.[7] Nonetheless, the administrative judge cannot accept the proposition that LAT "does not in substance have a true lease with the Foundation." Post-Trial Brief, p. 7. In Dismas Charities Properties, Inc. (Shelby County, Initial Decision and Order, July 8, 2005), cited by Mr. Krivacka, a "501(c)(2)" title holding company that was formed by a nonprofit corporation devoted to the rehabilitation of ex-convicts sought exemption of a "community corrections center" operated under contract with the Federal Bureau of Prisons. Although the property was leased to the titleholder's "single parent" (Dismas Charities, Inc.) for thousands of dollars per month, the undersigned administrative judge attributed ownership of such property to the "lessee" which effectively controlled the owner. On that rationale, the halfway house was granted exemption in spite of the amount of "rent" due under the lease.

By contrast, in this proceeding, the property owner (FC) and the lessee (LAT) appear to be unaffiliated entities. Hence the monthly rent specified in the master lease agreement cannot likewise be disregarded as an "internal accounting arrangement." Post-Trial Brief, p. 8.

Finally, the administrative judge is unable to perceive how leasing the subject properties directly to LAT's developmentally disabled clients would improve the appellant's position with respect to the claimed exemptions. Unlike the organization to which ownership of the halfway house was attributed in Dismas Charities Properties, FC provides no on-site services

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[7]However, paragraph 15(a) of the master lease explicitly states that any non-payment of rent due under the subleases does not relieve LAT of its contractual obligations to FC.

whatsoever. In that scenario, then, the subject properties would not even be "occupied and used" by an exempt institution.

Order

It is, therefore, ORDERED that the initial determination of the State Board's staff attorney be affirmed.

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **"must be filed within thirty (30) days from the date the initial decision is sent."** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **"identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order"**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 13th day of November, 2006.

Pete Loesch

PETE LOESCH
ADMINISTRATIVE JUDGE
TENNESSEE DEPARTMENT OF STATE
ADMINISTRATIVE PROCEDURES DIVISION

cc: Paul D. Krivacka, Esq., Adams & Reese, LLP
Ralph Bowers, Greene County Assessor of Property

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